Do reverse mortgages help out?

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Imagine that you are about to retire. Everything looks OK, but just OK. You own a very nice house, your health is good, you have no debts, you're about to get Social Security benefits, and you have some savings. Sadly, you won't have all the income you wanted, mostly because the last 15 years haven't been kind to your savings.

Lots of people are in this boat.

What can you do to make things better? Would you like to boost your spendable income by 25 to 50 percent? For the rest of your life? Then listen up. A reverse mortgage line of credit may be your new best friend. This is a type of loan that allows you to borrow against the equity in your home with some protection against the loss of your house.

While recent research has shown that reverse mortgages can be a powerful tool for retirement income planning, until now I hadn't seen any work that objectively measured how big an impact a reverse mortgage can have.

Planning ahead

Then I met Brian Vezza, who is a physicist and an Internet of Things consultant in Dallas. He's a systems thinker who loves the elegance of the consumption- smoothing software that I've written a good deal about, ESPlanner. He knows it so well that he is a beta tester for updates.

ESPlanner doesn't guess at the standard of living you can have in retirement. It uses dynamic programming to calculate a constant standard of living you can have from any age you choose until you die.

Make a change, and it will tell you how much your lifetime standard of living will rise or fall.

Some people use the software to figure out how much a higher (or lower) return on their investments will affect their retirement. They do the same thing with saving more, or less. And they can also test the impact of retiring earlier or later, downsizing, moving to a state with no income tax, etc. Vezza knows all about that.

But he has also explored the impact of taking out a reverse mortgage line of credit. It's big. Indeed, if you are looking for a big lever, a reverse mortgage line of credit will be the most powerful tool available for many people.

Doing the math

Skeptical? I don't blame you. So let's examine two of Vezza's case studies. These case studies assume 3 percent inflation, a 6 percent rate of return, California residency, low property taxes and living to age 95.

Mr. and Mrs. Housepoor. This couple is already retired, ages 77 and 76, with $2,000 a month in Social Security benefits, savings of $150,000, and a house worth $443,000. If they do nothing, they will have $30,300 a year in constant purchasing power for the rest of their lives.

That $30,300 is what they have to spend after paying income taxes, Medicare premiums and the operating expenses for their house.

But if they take out a reverse mortgage line of credit, their lifetime consumption will rise to $45,700 a year in constant purchasing power. That's a 50.8 percent increase in the money they can spend on daily living. The additional income they receive won't be taxable, but they will be building a debt against their home equity. How much, if any, home equity they will have at death will depend on future real estate appreciation.

Mr. and Mrs. Notready. This couple lost their jobs before they were ready to retire. Now 67 and 65, they have $2,000 a month in Social Security benefits and only $70,000 in savings. They own a $200,000 house. If they do nothing, their lifetime consumption will be $20,000 a year in constant purchasing power. But if they take out a reverse mortgage line of credit, their lifetime annual consumption will be $25,900 a year. That's a 29.5 percent increase. It's smaller than the increase for the Housepoors because their credit line is smaller.

Bulking up wealth

How does all this fit in the Big Picture of retirement readiness?

Simple: It could be the most powerful tool most people have.

In May I wrote about "the thinness of wealth": how about 80 percent of all households had more money in home equity than they had in their combined financial assets and retirement accounts.

Think about that — 80 percent. It tells us that whether it is a reverse mortgage, downsizing, right-sizing, renting or living in a trailer, our shelter decisions will make the difference between retirement squeeze and retirement comfort.

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